# Weekly Updates Issue # 650

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## 1. Weekly Markets Changes

**[February 9, 2018]**

| S&P TSX | S&P 500 | Dow Jones | NASDAQ | CAD/USD | Gold | WTI Crude |
|---|---|---|---|---|---|---|
| 15,034.53<br>-571.5 -3.66% | 2,619.55<br>-142.6 -5.16% | 24,190.90<br>-1,330.1 -5.21% | 6,874.49<br>-366.5 -5.06% | $0.8116<br>-1.85c -2.28% | $1,316.65<br>-16.74 -1.26% | $59.20<br>-6.25 -9.55% |

## 2. After brief shutdown, Congress funds government for 6 more weeks

**[February 9, 2018]** While you were sleeping, Congress was shutting down the government—and then reopening it—for the second time this year, while they staged standoffs intended to draw attention to their causes. The first shutdown of 2018, which occurred in late January, was the result of lawmakers letting funding lapse over Senate Democrats' strategy on immigration.

This second episode was less about strategy. After little action Thursday, a single senator dug in, forcing the Senate to stall and miss the midnight deadline. Lawmakers then had to rush to turn the lights back on before federal employees were due to report to work.

What follows is a recap of the action overnight and early Friday.

### How did we get here?

The government has been operating on funding from a series of short-term spending measures. Three weeks ago, Senate Democrats dug in and decided to use a deadline to try to force Republicans to work with them on a deal for immigrants, whose protections from deportation are due to expire in March. No deal came together and the government shut down between Jan. 20 and 22. Ultimately, Senate Majority Leader Mitch McConnell, R-Ky., agreed to hold votes on an unspecified immigration bill in return for Democrats' votes to reopen the government for three more weeks.

**Didn't they have a deal?**

Yes. Senate leaders used the three weeks to hash out a two-year, $400-billion budget agreement. McConnell and Senate Democratic leader Chuck Schumer announced it this Wednesday, lauding it as a major breakthrough. The deal found support in both parties largely because it has something for everyone—both the military spending Republicans wanted, and the money for domestic programs Democrats sought. It also includes $89 billion for disaster relief sought by both parties.

**What was the problem?**

The bill does nothing on immigration. That's the problem for Democrats, at least, especially in the House, where no vote has been promised on so-called dreamers, who have lived in the country illegally since they were children. For some Republicans, the problem was too much spending.

The budget will put the U.S. on track to reach a $1-trillion deficit. For some fiscal conservatives who just spent years opposing President Barack Obama's deficits, that's tough to swallow. Still, leaders expected they could thread the needle to find the votes to pass the bill in both the House and Senate.

**Where did this go wrong?**

From the beginning, the Senate had to move fast to pass the deal. But Sen. Rand Paul, R-Ky., a fiscal conservative and resident contrarian, pumped the brakes, using his objection allowed under Senate rules to delay a vote until after 1 a.m. Friday. By the time the Senate passed the deal just before 2 a.m. this morning, the government had been officially shuttered for nearly two hours. The House rushed to approve its version, wrapping up the vote just after 5:30 a.m. President Donald Trump signed the bill three hours later, reopening the government.

**So, did it matter?**

The brief shutdown likely won't register for most people. Congress and the president acted in time to allow federal employees to get to work on Friday, keeping disruptions to a minimum. The budget deal approved by Congress matters a lot to the Pentagon, and for domestic programs for opioids, health centres and research funding. The budget agreement will set spending for programs for the next two years—if they stick to it.

Under the short-term agreement approved early Friday, the government is funded for another six weeks to give lawmakers time to craft a budget plan. If they don't have something long-term in place by then, the country could be in shutdown mode again in March.

## 3. Why you shouldn't overreact to January's labour market slump

**[February 9, 2018]** The number of jobs in Canada fell by 88,000 in January to give the labour market its steepest one-month drop in nine years, Statistics Canada said Friday.

The overall number was dragged down by a loss of 137,000 part-time positions in what was easily the category's largest one-month collapse since the agency started gathering the data in 1976.

Statistics Canada's latest jobs survey said the net decline helped push the national unemployment rate up to 5.9% in January, from a revised 5.8% the previous month.

But on the other hand, the agency said the economy generated 49,000 full-time positions last month.

"Overall, a mysterious mix of good and bad, with the latter's impact blunted by how strong job gains were in the lead-up to these figures," CIBC chief economist Avery Shenfeld wrote in a research note to clients.

"January saw an [88,000] drop in employment, reversing about half of the spectacular gains we registered late last year. But the details [are] also looking wonky, with all of the job losses in part-time work," he said.

Even with the overall decline in January, Canada has been on a strong run of job creation that has seen the country add 414,100 full-time jobs over a 12-month period. The growth represents an increase of 2.8%.

Over that same period, the number of less desirable part-time positions declined by 125,400 or 3.5%.

The January reading marks the end of a 13-month streak of job gains—about half of those positive numbers were within the survey's margin of error.

James Marple, senior economist at TD Bank, said in a data commentary note that the numbers don't "change the story for the Canadian economy much. The unemployment rate is still low, with the economy remaining close to full employment."

Marple also forecasts that today's jobs report "doesn't much change the outlook for the Bank of Canada, but suggests a more rational pace of job growth consistent with an economy that is moving toward a more neutral pace of growth after a very robust year."

A closer look at the data revealed that the number of paid employee positions dropped by 112,000. By comparison, the number of people who identified as self-employed workers—often seen as a less desirable category that includes unpaid work in a family business—increased last month by 23,900.

Wage growth also received a boost in January, a month that saw Ontario lift its minimum wage. Compared with the year before, average hourly wages for permanent employees expanded 3.3%.
By region, the agency said Ontario and Quebec saw the biggest decreases last month, while New Brunswick and Manitoba also had net losses.

## 4. Commodity prices not best way to predict loonie's value: report

**[February 8, 2018]** Commodity prices aren't the best predictor of the Canadian dollar's future exchange rate, according to a new study from the C.D. Howe Institute.
In "Understanding the volatility of the Canadian exchange rate," authors Martin Eichenbaum, Benjamin K. Johannsen and Sergio Rebelo find the current real exchange rate is more useful than commodity prices for forecasting changes in the Canada/U.S. nominal exchange rate.
The report looks at the historical determinants of the Canadian/U.S. dollar nominal exchange rate and whether they can be used to accurately forecast long-run future rates. (The nominal exchange rate is how many U.S. dollars can be exchanged for a loonie, while the real exchange rate is the relative cost of a typical bundle of consumer goods in Canada compared to the U.S.)
Canada's real exchange rate with the United States is mean-reverting, the report says: when the real exchange rate is high, it tends to fall to its long-run average. This is because the shocks driving the rate (movement in commodity prices, changes in government spending and temporary shocks to the U.S. economy) aren't permanent, the authors say.
They also find the current real exchange rate "displays a tight negative correlation with future values of the Canadian dollar relative to the U.S. dollar." That's because Canadian and U.S. monetary policies are similar in that both countries use a short-term interest rate to control inflation and don't explicitly manage the exchange rate. As a result, there haven't been persistent changes in the relative price levels of the two countries.
"A fundamental question is whether Canadian policymakers are satisfied with the current inflation targeting regime," the report says.
A potential cost of this regime is that Canada's real exchange rate is highly volatile, the report says, while a benefit is that consumers and firms can mostly avoid potentially costly changes in nominal prices and wages that would be required if the nominal exchange rate did not adjust in a flexible manner.

The authors aim to compare these tradeoffs for policymakers, which they say "should play an important role in the process leading to the Bank of Canada's next five-year agreement with the government."

## 5. Housing starts hold steady in January: CMHC

**[February 8, 2018]** In January the number of housing starts in Canada kept pace with the previous month, says the Canadian Mortgage and Housing Corporation.

The government agency reported Thursday that the seasonally adjusted annual rate of housing starts was 216,210 units last month, compared to 216,275 in December.

Urban starts increased from 197,956 in December to 198,400, while rural starts saw a slight decline. Within the urban category, single-detached starts increased from 63,326 to 63,715 in January, while other housing was virtually the same as in December.

National Bank economist Jocelyn Paquet said in a research note on Thursday that housing starts still managed to top expectations of 210,000.

"Ontario really drove the show in the month, with urban area starts there jumping 20.8K (to 82.2K)," she wrote. Excluding Canada's largest province, starts were down 20,200—the largest decline since April—with B.C. and Quebec both decreasing.

Residential construction "faces several headwinds," including rising interest rates and stricter mortgage rules, she wrote. "That said, the strong labour market should help keep starts close to levels we consider sufficient to cover demographic needs (i.e., around 190K)."

## 6. Manulife reports $1.6 billion net loss in Q4

**[February 8, 2018]** Manulife Financial Corp. says a $2.8-billion post-tax charge related to U.S. tax reform as well as a decision to change its portfolio asset mix resulted in a $1.6-billion, or 83 cents per diluted share, net loss in the fourth quarter of 2017.

The company earned a net profit of $63 million, or a penny per share, in the year-earlier period, in which it declared a $1.2-billion charge related to the direct impact of markets.

Manulife CEO Roy Gori says the tax change that hit net income in the most recent quarter will benefit the company in the future, adding Manulife is "fully committed" to transforming its business to become a digital leader with stronger customer focus.

The financial services and insurance company says its quarterly dividend will increase 7% to 22 cents per common share, from 20.5 cents.

It says earnings before special charges in the fourth quarter were $1.2 billion or 59 cents per share, down 6% from $1.29 billion or 63 cents per share in the same period of 2016, due to lower investment gains. Strong growth in Asia business partially offset the lower gains.

For the year, Manulife says it had net earnings of $2.1 billion, or 98 cents per share, compared with $2.9 billion or $1.41 per share in 2016.

It says its core earnings before charges for 2017 were $4.56 billion, or $2.22 per share, up from $4.02 billion or $1.96 per share in 2016.

## 7. Ontario businesses report declining confidence

**[February 7, 2018]** Business confidence in Canada's largest province is on the decline.

A little more than half of Ontario businesses (54%) report confidence in their organization's economic outlook, reveals an annual economic report from the Ontario Chamber of Commerce (OCC). That compares to 62% in last year's report.

Further, declining confidence in Ontario's overall economic outlook has been observed since 2012. At that time, business confidence in the economy was at 47%; this year it's half that, at a low of 23%. (Confidence in Ontario's economy was at 24% in last year's report.)

"Industry in Ontario is feeling the impact of a rising minimum wage and substantial labour reforms, increasing global and U.S. competition, NAFTA renegotiations, consistent overregulation, rising input costs (particularly, electricity) and a tax system that is unable to relieve these pressures," says Rocco Rossi, president and CEO at the OCC, in the report.

Rising input costs are a key concern, as they were cited by almost two-thirds of businesses as a reason for lack of confidence. Beyond electricity, those costs include such things as taxes and raw materials.

Declining revenues for 2018 are forecast by one-quarter of small businesses in Ontario—that's twice the rate of large firms. For instance, the increase in the minimum wage is expected to be a negative factor, say 68% of businesses.

"Given that the majority of businesses in this province are small, this will likely have a net-negative impact on economic growth," says Rossi.

### More dependence on financial activities

An ongoing concern is that the production of goods and services represents a shrinking contributor to business prosperity in Ontario.

Production activities represent only 15.3% of business prosperity, meaning that prosperity is increasingly becoming more dependent upon financial activities instead of productive activities.

“This is indicative of Ontario possessing a higher-risk operating environment,” says Rossi.

## 8. Commercial real estate - trends to watch in 2018

**[February 6, 2018]** It will be another year of robust commercial real estate investment activity in Canada, given healthy demand for quality assets across the country, predicts real estate company Morguard Corporation in a report.

“Investors remain enthusiastic about the Canadian commercial real estate market after a record volume of transactions in 2017,” said Keith Reading, director of Research at Morguard, in a release.

The downtown areas of Vancouver and Toronto are expected to remain the most coveted markets for investment in 2018, the report says. But with a limited supply of properties available, investors will be forced to look for opportunities further afield. Suburban Toronto, Ottawa and Montreal are also expected to see strong activity levels in 2018 while Alberta, which had previously depressed country-wide statistics, is also showing signs of reanimation.

“Intense bidding for a limited pool of downtown properties will force investors to look elsewhere for opportunity,” says Reading. “Class A properties in suburban markets, particularly those near transit nodes, will be in high demand. Edmonton and Calgary will also see increased activity as investors look for high-quality assets in a recovering market and economy.”

### A look at retail properties

In the retail market, the Sears liquidation announcement will put a damper on near-term fundamentals in the country’s shopping centres. The departure will be partially offset by a steady stream of new international entrants to Canada.

Reading believes the retail market will continue to offer stable long-term opportunity for Canadian investors, as malls are being re-envisioned as investors and landlords turn to non-traditional tenants including medical, services, entertainment and government agencies as part of their transformation into community hubs.

With the pace of interest rate hikes expected to remain slow, a continued and abundant flow of low-cost debt and equity capital will power Canadian commercial real estate investment in 2018, notes the report.

## 9. Toronto home sales down 22% in January from year ago

**[February 6, 2018]** The number of homes sold in the Toronto region in January was down sharply compared with a year ago.

The Toronto Real Estate Board says Greater Toronto Area realtors reported 4,019 home sales for January through the MLS system, down 22% from a record 5,155 a year ago.

The average selling price was $736,783, down from $768,351 a year ago.

The move lower came as the number of new listings increased to 8,585 compared with 7,314 new listings entered in January 2017.

Toronto home sales started last year on a hot streak, but slowed after the Ontario government moved to cool the market.

A new stress test for homebuyers who do not require mortgage insurance that came into effect this year and higher mortgage rates have also weighed on the market.

## 10. New mortgage rules push borrowers to alternative lenders

**[February 5, 2018]** Mortgage brokers say the borrower rejection rate from large banks and traditional monoline mortgage lenders has gone up as much as 20% after Canada’s banking regulator imposed a new stress test for homebuyers who don’t need mortgage insurance.

As a result, alternative lenders are seeing an uptick in business as brokers increasingly direct homebuyers toward borrowing options that are beyond the reach of the Office of the Superintendent of Financial Institutions’ newly enacted tighter lending requirements.

Clients who don’t meet the bar are turning to private lenders, mortgage investment corporations (MICs) and credit unions, which are provincially regulated and not required to implement the stress test, said Carmen Campagnaro, president of Pro Funds Mortgages in Burlington, Ont.

Campagnaro is one of the brokers who said rejected loan applications to traditional lenders have risen by 20% since Jan.1, when OSFI mandated a new stress test for uninsured borrowers, or those who have more than a 20% down payment.

Private lender Fisgard Asset Management Corporation in Victoria is seeing an influx of borrowers and “better quality business,” said Hali Noble, its senior vice-president of residential mortgage investments and broker relations.

“A lot of these people should be bankable,” said Noble. “But they’re not.”

The guidelines, known as B20, are aimed at curbing risky lending amid rising household indebtedness and high home prices in some markets.

To get a loan from a federally regulated lender, homebuyers have to prove they can service their uninsured mortgages at a qualifying rate of the greater of the contractual mortgage rate plus two percentage points or the five-year benchmark rate published by the Bank of Canada. An existing stress test already requires those with insured mortgages to qualify at the Bank of Canada benchmark five-year mortgage rule.

Superintendent Jeremy Rudin has said OSFI is aware the stricter rules could have unintended consequences, such as sending borrowers toward riskier lenders that are out of the regulator's purview.

"We can't control what we can't control," he said in October.

"Our mandate is focused on the safety and soundness of the federally regulated institutions […]. It isn't something that we favour, but it isn't something that we have an authority to prevent."

Dave Teixeira, vice-president of operations, public relations and communications for Dominion Lending Centres, said Dominion mortgage brokers are seeing a higher rate of rejection and clients have to submit multiple applications to various institutions before finding a lender that works.

In turn, their brokers are submitting 80% more applications than last year, Teixeira said.

"Normally, we would see our volume going to the big banks and monolines, and now we're seeing a little bit more of that, roughly up to 20% […] moving over to credit unions."

## Voluntary implementation of rules

However, some credit unions have voluntarily implemented the new stress test or tightened their own requirements.

Quebec credit union Desjardins Group has been applying OSFI's new mortgage rules in full since Jan. 1.

"We believe it represents an effective way to protect consumers against interest rates variations," said Desjardins spokeswoman Valerie Lamarre.

Vancouver-based Vancity Credit Union has voluntarily increased the stress test its members must meet to qualify for a mortgage.

Rick Sielski, Vancity's senior vice-president of risk, would not disclose the mechanics of the stress test and said it was too early to gauge the impact of the new guidelines.

"What we're really trying to do is make sure we're serving our market, serving our members in a responsible way," he said.

## More biz for risky lenders

The higher bar for borrowers is also shifting business to riskier lenders.

Harold Gerstel, better known as Harold the Mortgage Closer from his television ads, said his Toronto-based mortgage arm is seeing an influx as well.

“We’re definitely getting more business. Whether it’s a substantial change, it’s too early to tell,” he said.

The new rules are sending better-quality demand down the credit line, said Robert McLister, a mortgage planner at IntelliMortgage and the founder of RateSpy.com.

“The demand is shifting down the ladder, so you have these less regulated lenders with higher risk tolerance now seeing materially more business. And they can charge more, and they can be pickier with the types of borrowers that they lend to.”

## Have a nice and fruitful week!